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In the Supreme Court of the United States

OCTOBER TERM 1940

No. 31

AMERICAN UNITED MUTUAL LIFE INSURANCE COMPANY,
Petitioner,

vs.

CITY OF AVON PARK, FLORIDA,
Respondent.

BRIEF OF PETITIONER

GILES J. PATTERSON,
Attorney For Petitioner.

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Vero Beach, 104 F. (2d) 59, and its opinion in that case appears to have been influenced by the fact that "the vast majority of the creditors of the City had consented", although the court in its opinion admitted that the speculation by the Agent in the obligations of its principal (the City) "might lead to discontents or even scandals", a contingency not contemplated or permitted by the Act of Congress authorizing this procedure 27

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vs.
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BRIEF OF PETITIONER

I.

Opinions Below

The opinion of the Fifth Circuit Court of Appeals is reported in 108 F. (2d) 1010.

II.

Jurisdiction of This Court

Jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, 28 U.S.C.A., Section 347(a) as amended by the Act of Congress of February 13, 1925, Chapter 229, Section 1, 43 Stat. 938.

The petition for certiorari was filed March 15, 1940, and the writ was granted on April 22, 1940.

The decision to be reviewed is that of the Fifth Circuit Court of Appeals rendered January 31, 1940, affirming *per curiam* on the authority of *Vallette v. City of Vero Beach*, 104 F. (2d) 59, a decree of the District Court in and for the Southern District of Florida, dated the 19th day of June, 1939.

III.

Statement of the Case

This proceeding is initiated under Sections 81, 82, 83 and 84 of Chapter IX of the Acts of Congress relating to bankruptcy. Petition was filed August 15, 1938, by the City of Avon Park, a municipal corporation, organized under the laws of Florida. The petition alleges that the City is in default in the payment of principal and interest of its outstanding bonds; that it has been unable to pay the same as they came due, and that it is impossible to collect sufficient taxes to meet its delinquent obligations. It, therefore, proposes to make a Composition with its creditors according to a Plan which is attached to the petition and marked Exhibit A (p. 16 et seq.). Paragraph 6 of the petition, (p. 8) alleges that the Plan of Composition "is embodied in that certain agreement made and executed July 17, 1937" between the City and R. E. Crummer & Company, a Delaware corporation; that "said agreement constitutes all of the understandings, agreements and plan of settlement of the bonded debt", and that "said agreement constitutes the sole and exclusive plan of settlement" of the City's indebtedness. The contract between the City and R. E. Crummer & Company is attached to the petition and marked Exhibit B (p. 27 et. seq.).

The Plan of Composition has been submitted to the creditors of the City (Sec. 8 p. 9), and creditors holding securities to the amount of $546,500. principal and $176,986.66 interest, which is more than 51% of the aggregate debt, it is alleged have executed written acceptances of the Plan. The petition also alleges (par. 12) that the Plan is fair and equitable, and for the best interests of the creditors.

The Composition offered involves the issuance by the City of refunding bonds in an aggregate principal amount equal to the principal of the bonds outstanding as of July 1, 1937, plus the interest which had accrued and was unpaid as of that date, in exchange for outstanding bonds and interest (Sec. 5, p. 8). The refunding bonds are to be dated July 1, 1937, to mature July 1, 1967, and to bear interest at the rate of 2% per year for 2 years from date, 3% per year for the next 6 years, 4% per year for the next 7 years, and 5% thereafter.

The contract of the City with R. E. Crummer & Company provides (Exhibit B, p. 28) that the latter shall "endeavor to accomplish a refunding, by a par for par exchange" of the new bonds for the old bonds and interest. By Section 8 (p. 35) the Fiscal Agent, as the corporation is designated in the contract, agrees to "defray all expenses incident to" (a) assembling the bonds to be refunded; (b) printing the refunding bonds; (c) representation of the City in legal proceedings to validate the refunding bonds; (d) obtaining the approving opinion of nationally recognized bond counsel upon the validity of the refunding bonds; (e) all other expenses in connection therewith which may be approved by first party; and (f) cost of retaining special counsel to assist the City Attorney in determining the responsibility of the various properties for debt service taxes, and by Section 9 (p. 36) the City agrees that the Fiscal Agent shall be reimbursed and compensated for

expenses and services by assessing charges against "security-holders *who accept refunding bonds under the terms hereof.*" The amount of the assessment is to be "a matter wholly between First Party (Crummer) and security-holders *who accept said refunding bonds.*" Exhibit A fixed the charge to be made against the participating bondholders at $20. per bond, but, according to the testimony of the Vice President of the Fiscal Agent (p. 172), participating bondholders were compelled to sell their interest accruals (coupons and accrued interest) to the Fiscal Agent at the exchange, at the rate of 2% per annum. The Fiscal Agent, in turn, agreed that it would hold interest adjustment bonds received by it in exchange for the coupons so purchased by it, subject to the order of the City for use in paying delinquent taxes; "Said bonds to be delivered by R. E. Crummer & Company upon the order of the City" at not exceeding 50% of their face value for the first 6 months, 60% for the next 6 months, 70% for the next 6 months and 75% for the next 6 months.

The American United Life Insurance Company is a creditor of the City and holds a judgment against the City, dated October 1, 1936, in the sum of $13,942.50, and 35 bonds of the par value of $35,000. upon which interest amounting to $4,550. had accrued and was unpaid on July 1, 1937. Its Answer (p. 63) opposed granting of the petition of the City on the ground that the Plan was not fair and equitable by reason of the terms of the contract with the Fiscal Agent, and was a discrimination by the City in favor of the claims of the Fiscal Agent.

The Fiscal Agent, R. E. Crummer & Company, is a Delaware corporation, organized in 1934 (p. 62) "almost exclusively for the purpose of representing clients of the Brown-Crummer Investment Company, a Kansas corporation, who had purchased bonds in Florida that were then in default in substantial amounts". The two companies

are owned and controlled by the same persons, and the same individual is president of both corporations (pp. 162, 178, 189 and 192). The two companies own the following claims against the City: (See Master's Report, p. 214 et seq.).

Claim No.	Aggregate Prin. Amt.	Interest Accrued to 7-1-37
10	$3,000.00	$ 1,305.00
15		25,243.33
45	10,000.00	450.00
46	24,000.00	58,535.00
47		3,460.00
52	95,000.00	14,168.33
53	1,000.00	1,540.00
54	146,000.00	35,774.17
	$279,000.00	$140,475.83

Just when these claims were purchased by these corporations, is not clear, but the testimony of the Vice President of the Fiscal Agent (pp. 169, 170, 177, 203 and 204) establishes beyond doubt that one or both of the corporations owned a substantial portion of these claims at the time the Fiscal Agency contract was entered into with the City. Some of the bonds, coupons and judgments owned by the two corporations were purchased after the contract was made (p. 170). The price which the Fiscal Agent and its affiliated corporation paid for the bonds, coupons and judgments owned by them was approximately 50% of their face value (p. 170). They were bought flat,—that is, the purchase price made no specific allowance for accrued interest.

When representatives of R. E. Crummer & Company opened negotiations with the City, they went there "as a representative of bondholders" (p. 199), but afterward the corporation entered into the contract (Exhibit B. p. 26) to

act as Fiscal Agent for the City to carry out a plan of refunding (p. 27, first par., and p. 28, Sec. 1). The Vice President of R. E. Crummer & Company testified (p. 163) that it was the duty of the company under the contract "to attempt to complete a refunding of the indebtedness" of the City, and to perform "all technical services that had to be performed, in order to accomplish those results, and presenting the plan to bondholders and making exchanges". After the contract was executed, the Fiscal Agent immediately began to assemble information (pp. 164-165) necessary to enable it to present a Plan. It made a survey of the outstanding debt, and prepared a set of resolutions and papers to authorize the issuance of refunding bonds. These were submitted to the City Council for approval. Proceedings to validate the bonds were prepared and filed by Mr. Jollay, who had represented the Fiscal Agent in other matters. Representatives of the Fiscal Agent personally interviewed creditors to secure their consent to the plan (p. 171). Its representatives discussed the matter 15 or 20 times with the representatives of the American United Life Insurance Company (p. 206).

Meantime, a Plan of Composition, embodying the provisions of Section 10 of the Contract (Section 9 of the original Plan, pp. 24 and 25) had been presented by the City of Vero Beach to Judge Holland of the District Court, who refused to approve it because it would coerce bondholders into selling their interest claims to the Fiscal Agent at a discount. The Vero Beach Plan was amended, and the amendment was "transferred to the Avon Park Plan practically verbatim" (p. 197). Avon Park then amended its Plan (Exhibit A, p. 86 et seq.). The only changes made from the original Plan were in the provisions relating to compensation of the Agent and disposition of the past due interest claims. Under the amended Plan, compensation of the Fiscal Agent for its services and reimbursement for its costs are still to be assessed

only *"against the participating bondholders,* the amount of such charges to be a matter between the Fiscal Agent and the bondholders participating in the Plan", but the charge is set at $40. per bond instead of $20. as originally provided. Amended Section 9 provides that the participating bondholders are required to deposit "evidences of all interest accrued to July 1, 1937 with an escrow agent which would issue to the depositors certificates" showing the amount deposited, and the escrow agent would then reduce the amount of such claims upon the receipt of the proceeds of tax collections from delinquent taxes during a period of 2 years at the same rates of discount fixed in the original Plan. After 2 years, the escrow will be closed, and refunding bonds equal to the unpaid balance will be delivered to the escrow agent for distribution to the holders of the certificates of deposit. By a proviso, (p. 99) depositors may, if they so elect within 10 days after the issuance of certificates to them, "receive from the Fiscal Agent, R. E. Crummer & Company, in lieu of said certificates, an amount of money equal to the sum which would be payable if the interest accruals to July 1, 1937 had evidenced at the rate of 2% per annum" in exchange for the assignment of their certificates and the payment of $20. per bond instead of the $40. otherwise required.

The Master's Report shows that holders of more than the 66⅔% of the outstanding bonds executed written acceptances of the Plan (p. 224). But it also shows that of the 66⅔% of claims who accepted, $419,475.83, or 34.2%, were owned by R. E. Crummer & Company or Brown-Crummer Investment Company. If only the claims owned by R. E. Crummer & Company are deducted from the total listed as having accepted, the Plan will not have been accepted by the percentage required by statute.

City officials, including two Clerks, a City Auditor, and a member of the City Council, all testified that they took

no active part in preparing the Plan or in soliciting acceptances of it, or in preparing legal proceedings. Mr. Jollay acted as attorney for the City in the validation proceedings, and originally in the present proceedings (pp. 15, 45, 102 and 150). In the Circuit Court of Appeals, the City was represented by Mr. Pleus, who is representing it in this Court. At the first hearing before the Master (p. 195) he appeared as counsel for the Fiscal Agent. It is admitted (p. 177) that the refunding bonds when issued will not be worth their face value. The Fiscal Agent says (p. 177) that they will not be worth more than 50% for 6 months after they shall have been issued; that the City will not have to pay the bonds at par; that it probably will not be able to pay them at par (p. 177) because success of the plan is "dependent upon the ability (of the City) to buy in these bonds at reduced values through a period of years, both through the escrow fund and other sources". (p. 190). In other words, the principal of the new debt is an artificial structure, and successful liquidation of it will depend upon market manipulation by the City. The City does not intend to pay the principal and interest in the amounts which the bonds specifically promise to pay, and the amount which the various bondholders will receive for their bonds is purely speculative. This conclusion is fortified by the fact that the principal debt of the City will be increased by $358,251.76 (the interest which had accrued as of July 1, 1937), less such portion thereof as may be liquidated during the first 2 years through the operation of the escrow arrangement. The increased principal will be placed upon an interest bearing basis. Since the City was not able to pay principal and interest accruing on its original indebtedness of $895,000.00, it is improbable that it will be able to pay principal and interest on an indebtedness aggregating over one million dollars. The artificial structure of the debt also presents an opportunity for the Fiscal Agent to profit through speculation in the claims it now owns, and in those which it may hereafter

urchase, because sub-section (A) of Section 10 (Exhibit
3. p. 36) gives the Fiscal Agent "exclusive authority to
ct for and on behalf of Second Party (the City) in all
natters connected with, or relating to, the exchange of the
resently outstanding securities for refunding bonds," and
ub-section (F) of the same section (p. 38) prohibits the
ity from making settlements with any other creditor until
fter it has given notice to the Fiscal Agent of its intention
o to do.

The record sustains the allegations in the Answer of
he insurance company (p. 67) of discrimination by the
ity in favor of the Fiscal Agent. Prior to, or about the
ime, the Fiscal Agent entered into a contract with the
ity (p. 175) it instituted a mandamus proceeding against
he City in the name of Meredith, Rogers and Martin, who
ere "officers or parties connected with the Fiscal Agent
r Brown-Crummer Investment Company" (p. 178). At
irst, the City contested the case, but after entering into
he contract with the Agent, it withdrew its opposition
p. 175) and levied a tax for the payment of the claim. At
he same time, it deliberately ignored the command of
ther writs issued by Federal and State courts on behalf of
etitioner and other creditors, ordering the City to levy
axes for the payment of their claims. The City has
ollected a sum of money from the levy which it made for
ne writ of the Fiscal Agent. This fact was not disclosed,
ither in the Plan or in the petition. On page 200, the
ice President of the Fiscal Agent says that the money
as to be used to meet the first year's appropriation for a
inking fund under the refunding plan, and orally waived
ne rights of the relators (and of the Fiscal Agent) in
avor of "creditors as a whole," but this waiver was not
ade until after the bankruptcy petition had been filed
nd until after existence of the fund had been disclosed.
he decree (p. 248) recites that owners of the writ have
aived their rights and have directed that the money col-

lected be used "under the refunding plan". If the Plan had not been confirmed, the proceeds of the levy would have been paid to the Agent.

IV.

Errors Assigned

The errors assigned are:

1. That the decision of the Circuit Court of Appeals of the Fifth Circuit rendered January 31, 1940, is contrary to the law of Florida, as announced by the Supreme Court of Florida in its decision dated February 23, 1940, in the case of *Taylor v. Williams*, 195, So. 175. The opinion in that case was reaffirmed on rehearing in 195 So. 181, and again in 196 So. 214, Advance Sheets.

2. That by affirming the decree of the District Judge, the Circuit Court of Appeals of the Fifth Circuit held contrary to law that the bonds and coupons of the City which were owned by the Fiscal Agent, a foreign corporation, could be counted in determining whether the City had secured the consent of the required two-thirds of its outstanding debts, when it appeared without contradiction that the Fiscal Agent would profit by reason of its speculation under the terms of its contract with the City in the securities of its principal, the City of Avon Park, at the expense of other bondholders, and in a manner which inhibited the District Judge from determining that the compensation which the Agent would receive for its services was reasonable.

3. The decision of the Circuit Court of Appeals of the Fifth Circuit affirming the decree of the District Judge is in conflict with the decision of this Court in the *Los Angeles Lumber case*, 84 L. ed. 22, because affirm-

ance was predicated solely upon its previous opinion in *Vallette v. City of Vero Beach,* 104 F. (2d) 59, and its opinion in this case appears to have been influenced by the fact that "the vast majority of the Creditors of the City had consented," although the court in its opinion admitted that the speculation by the Agent in the obligations of its principal (the City) "might lead to discontents or even scandals," a contingency not contemplated or permitted by the Act of Congress authorizing this procedure.

POINT I.

The decision of the Circuit Court of Appeals of the Fifth Circuit rendered January 31, 1940, is contrary to the law of Florida as announced by the Supreme Court of Florida in its decision dated February 23, 1940, in the case of Taylor v. Williams, 195 So. 175.

This point was the first ground of the petition to this Court for writ of certiorari.

Prior to the decision by the Fifth Circuit Court of Appeals in this case, the Supreme Court of Florida had not passed upon the validity of a contract similar to that embodied in Exhibit B (p. 26). But on February 23, 1940, 23 days after the decision of the Circuit Court of Appeals, it rendered an opinion in the case of *Taylor v. Williams,* in which was involved the validity of a contract between R. E. Crummer & Company and Lake County, Florida, that was substantially the same in its terms as the contract of that company with the City of Avon Park. The similarity of the provisions of the two contracts is shown herewith in parallel columns:

Taylor v. Williams	*Avon Park*
"That first party (R. E. Crummer & Company) shall defray all expenses incident to:	"Section 8. (A) That First party shall defray all expenses incident to:

(a) assembling and exchanging the bonds herein proposed to be refunded:

(b) printing the said refunding bonds;

(c) the representation of Second party (the county commissioner) in legal proceedings to validate said refunding bonds;

(d) obtaining the approving opinion of nationally recognized bond counsel upon the procedure used for the issuance and validation of said Refunding Bonds, said counsel to be selected by First party;

(e) all other expenses in connection herewith which may be approved by First Party."

(a) assembling the bonds herein proposed to be refunded;

(b) printing the said Refunding Bonds;

(c) the representation of Second Party in legal proceedings to validate said Refunding Bonds;

(d) obtaining the approving opinion of nationally recognized bond counsel upon the procedure used for the issuance and validation of said Refunding Bonds, said counsel to be selected by First Party;

(e) all other expenses in connection herewith which may be approved by First Party;

(f) the cost of retaining special counsel to assist the City Attorney in determining the legal responsibility of the various properties which have at one time or another been within the supposed corporate area of Avon Park, Florida, for debt service taxes, said special counsel to be selected by First Party."

The first opinion by the Supreme Court of Florida in the *Taylor* case is reported in 195 So. 175, where, referring to the contract, the court said:

> "Section 5, Article VIII, Florida constitution as amended in 1900, provides for the division of each county into districts and for the election of one county commissioner from each of such districts, whose powers, duties and compensation shall be prescribed by law. Statutes authorizing the county commissioners to issue bonds and refunding bonds for the county and the road and bridge districts therein, require official action in the issue of bonds and in all matters pertaining thereto which are functions or duties involving discretion and fiduciary attention to conserve the best interests of the county, the road and bridge districts therein, and the citizens, residents and taxpayers thereof.
>
> Appellant's question No. XI:
>
> 'Is the new 2 percent refunding agreement dated August 7, 1939, complained of in the Taylor bill (Taylor Record, page 43) void, and should its performance have been enjoined?'
>
> In the issuing of bonds to be paid by taxation, the official duties of the county commissioners include the administrative function of providing directly for the printing, approval and other legal or fiscal matters, not including mere technical or ministerial services which may be performed by employees. As shown by the resolutions adopted August 7, 1939 by the county commissioners, the contract of August 7, 1939, states that R. E. Crummer & Company, 'first party' is 'a Delaware Corporation', and the county commissioners 'second party'. As stated in the agreement of August 6, 1935, R. E. Crummer & Company 'represents the holders of a substantial portion of the outstanding bonds of Lake county'. The law does not contemplate or permit the appointment of a foreign corporation representing 'the holders of a substantial portion of the outstanding bonds' as fiscal agent for the county or districts in managing or controlling any of

the official functions involved in the issuing of refunding bonds. The contract of August 7, 1939 provides:

'That first party (R. E. Crummer & Company), shall defray all expenses incident to: (a) assembling and exchanging the bonds herein proposed to be refunded; (b) printing the said refunding bonds; (c) the representation of Second party (the county commissioner) in legal proceedings to validate said refunding bonds; (d) obtaining the approving opinion of nationally recognized bond counsel unon the procedure used for the issuance and validation of said Refunding Bonds, said counsel to be selected by First Party; (e) all other expenses in connection herewith which may be approved by First Party.'

Nor does the law permit the payment of money from the sinking funds of the county or districts as fees for a refunding agent. Pierce v. Isaac, 135 Fla. 101, 184 So. 669. When such an agent may legally be employed for services in no wise official in their nature, proper compensation for such service may be provided for as the law authorizes.

The refunding resolutions and contracts are not in accord with law, and the bill of complaint should not have been dismissed. This is a taxpayer's suit and not a bond validating proceeding.

Decree reversed for proper proceedings and decree."

In the companion case of *W. J. Howey Co. et al. v. Williams,* 195 So. 181, the court said:

"The law contemplates that all official authority, duties and functions shall be exercised and performed by duly commissioned officers; the delegation of official authority, duties or functions by officials to nonofficials is not permitted by the laws of this State."

Petition for rehearing was filed, and on April 2, 1940, the court rendered a second opinion in both cases, reported in 195 So. 184. From the majority opinion we quote the following:

> "The Howey opinion refers to the conclusions stated in the Taylor opinion as to the illegal provisions of the refunding contracts and resolutions.
>
> . . . . . .
>
> References in the Howey opinion to the refunding resolution and contract of 1939, which were in part quoted in the Taylor opinion, with conclusions thereon, made it unnecessary to quote or to cite in the Howey opinion similar provisions in the refunding contract and resolutions of 1935, the illegal provisions of the two contracts having the same effect, and the two cases were presented as companion cases."

Two members of the court in a concurring opinion held that the contract did not require the Agent "to perform official duties of the City", but only "to defray the expenses" and to be reimbursed therefor, and that the contract did not, in their opinion, vest the Agent with power "to manage or control official functions".

A second petition for rehearing was filed, and a third opinion was rendered by the Supreme Court of Florida, which is reported in 196 So. 214. This time the court unanimously affirmed its first opinion. The opinion goes even farther and holds that money which had been paid to the Agent by the county as compensation for services rendered by the Agent under the contract could be recovered because of the illegality of the contract under which it was paid.

It is not necessary in this case to determine whether the decision by the Florida Supreme Court that the contract in the *Taylor* case was void (1) because the Fiscal

Agent was a foreign corporation, or (2) was because the Fiscal Agent, at the time it entered into its contract with the City, was the representative or owner of a substantial portion of the bonds of the City, or (3) was because the contract required the Agent to perform "official functions which under the law of Florida could be performed only by the officials" of the City.

(1) If the contract of R. E. Crummer & Company (a Delaware corporation) with Lake County was illegal because the court was of the opinion that a foreign corporation could not act in the capacity of fiscal agent of a city (or county), then the contract of R. E. Crummer & Company with the City of Avon Park is void for the same reason.

(2) If the contract of R. E. Crummer & Company with Lake County was illegal because at the time the contract was made the corporation was already representing "a substantial portion of the bonds of the county", then the contract of R. E. Crummer & Company with Avon Park is also illegal, for it was not only representing a substantial portion of the City's bonds both before and after the contract was made, but it was also the owner of a substantial portion. After the contract was made, it purchased others. It was first agent for itself and other creditors, and then became Agent for the City, thus serving conflicting interests.

(3) If the contract of R. E. Crummer & Company with Lake County was illegal because it contemplated the performance by the corporation of "functions or duties which by law had been imposed upon officials of the" City and which could not be delegated, the contract of R. E. Crummer & Company with Avon Park is illegal for the same reason, because the duties and obligations of R. E. Crummer & Company under the two contracts are identical.

Section 10, Chapter 12514, enumerates the officers of the City. Section 19 requires an oath of office and furnishing of Surety bond. Section 24 gives the Council power to pass all ordinances for the government of the City, and Section 25 specifically gives the Council power to borrow money and issue bonds, which necessarily includes the administrative function of providing directly for the printing, approval, and other legal or fiscal matters. Section 17 provides for the election of a City Attorney, who shall perform all duties imposed by the charter and which are or may be prescribed by ordinance. (See Appendix A for excerpts from City charter).

Nor can it now be contended that the contract merely provided for reimbursement for expenses and services. The Vice President of R. E. Crummer & Company testified that it was "the duty of the Agent to complete the refunding and to perform all the technical services that had to be performed in order to accomplish this result" (p. 163). This statement of the Fiscal Agent is consistent with the testimony of the City officials, all of whom assumed that the Agent was required to perform such service (pp. 125, 126, 142, 155 and 158). All legal services, including preparation of resolutions of the City Council, validating proceedings, and conduct of this proceeding in bankruptcy, have been rendered by counsel for the Fiscal Agent. Since the contract has been so construed by the Fiscal Agent and the City, and since the record shows that the officials of the City performed no duties, and that the Fiscal Agent did perform those duties, it is not possible to construe the contract as involving only reimbursement and compensation. If the contract between R. E. Crummer & Company and Lake County was illegal because the contract delegated to a foreign corporation, which represented a substantial portion of the bonds, the performance of functions that by law were required to be performed by City officials, then the contract between that corporation and the City of Avon Park is also illegal.

All conditions that could possibly have rendered the contract with Lake County illegal are present here.

In the *Taylor* case, supra, payment for the services and reimbursement for expenses was an obligation of the county itself. In this case, the City agreed that the bondholders should pay the Fiscal Agent for its performance of official functions of the City. If the contract between the Fiscal Agent and Lake County was illegal, the contract between the Fiscal Agent and the City of Avon Park is illegal, and the decree of the District Judge confirming the Plan must be reversed.

Moreover, sub-section (a) of Section 403, 11 U. S. C. A., makes "legal authority (of the City) to carry out the Plan of Composition" a condition precedent to confirmation. The contract between the City and the Fiscal Agent (as the petition alleges) (p. 8) constitutes the "sole and exclusive plan of settlement". The City itself says that it is an integral part of the Plan. If the contract is illegal, the Plan is illegal, and the City has no authority under the law of Florida "to carry out the Plan". If Lake County could not legally pay for services rendered to it, because its contract with R. E. Crummer & Company was illegal, a Federal Court cannot coerce bondholders of Avon Park into paying the Fiscal Agent fees fixed by its illegal contract with the City, or compel them to deposit their interest claims in an escrow in which the Fiscal Agent will share, or else sell them to the Agent at a discount. Absence of authority on the part of the City to carry out its contract is fatal to this entire proceeding, and the District Judge would probably have dismissed the petition had the decision in the Florida Supreme Court been rendered prior to the date of the decree of the District Court.

POINT II.

By affirming the decree of the District Judge, the Circuit Court of Appeals of the Fifth Circuit held contrary to law that the bonds and coupons of the City which were owned by the Fiscal Agent, a foreign corporation, could be counted in determining whether the City had secured the consent of the required two-thirds of its outstanding debts, when it appeared without contradiction that the Fiscal Agent would profit by reason of its speculation under the terms of its contract with the City in the securities of its principal, the City of Avon Park, at the expense of other bondholders, and in a manner which inhibited the District Judge from determining that the compensation which the Agent would receive for its services was reasonable.

Sub-section (d) of Section 403, 11 U. S. C. A., provides that the "Plan of Composition shall not be confirmed until it has been accepted in writing by, or on behalf of, creditors holding at least two-thirds of the aggregate amount of claims affected by such plan". The Master's Report (p. 214 et seq.) finds that the total of principal claims allowed that had filed acceptances of the Plan, amounted to $627,-500., and that the total interest claims which had accrued to July 1, 1937, that had accepted, amounted to $207,766.66, —a total of both classes of claims of $835,266.66, which is more than two-thirds of the total debt. But, included in the list of claims allowed and accepting the Plan (p. 214 et seq.) are Nos. 10, 46 and 54, owned by the Brown Crummer Investment Company totalling $268,614.17, and Nos. 15, 45, 47, 52 and 53, owned by R. E. Crummer & Company, the Fiscal Agent, totalling $150,861.66. If we deduct the claims owned by the Fiscal Agent alone, from the total claims allowed and which have accepted, the total claims that have accepted is reduced to less than two-thirds of the aggregate claims outstanding. Since the decree of the court rests upon its finding (p. 244) that "the holders

of securities representing more than 66⅔% of the aggregate amount of claims of all classes affected by the plan have filed consents to the said plan in writing", and since the court is by statute (Sub-section (d), Section 403, Title 11 U. S. C. A.) prohibited from confirming the Plan unless that fact be true, it is apparent that if the claims owned by the Fiscal Agent had not been counted by the Master in the number that have accepted the Plan, the decree of confirmation would not have been entered. It is a fundamental principle of bankruptcy that "equality between creditors is necessarily the ultimate aim of the bankruptcy law, and to obtain it we must regard the essential nature of transactions, not their forms". *Clarke v. Rogers*, 228 U. S. 533, 57 L. ed. 953. Composition in bankruptcy rests upon a contract between the debtor and a majority of its creditors, and all creditors shall be treated alike. If the consent of any creditor to the acceptance of the composition has been obtained by reason of special advantage that would inure to him from a decree of confirmation, his acceptance should not be counted. If the consent of two-thirds has not been obtained except by the granting or promising of some special advantage or consideration to one or more creditors, the composition cannot be confirmed.

At the time the Fiscal Agent entered into its contract with the City, the first Act relating to municipal bankruptcy had been declared void, and the present Act had not been passed. The Vice President of the Fiscal Agent testified that the contract "contemplated a voluntary exchange" (p. 195). Under the terms of that contract, the only bondholders who would have been assessed for the expense of the proceeding were the "security holders who accept refunding bonds under the terms hereof" (p. 36). The only bondholders who would have been required to sell their interest claims to the Fiscal Agent by Section 10 of the contract (p. 37) were those who agreed to accept refunding bonds. In the Plan, those holders to be assessed are referred to as "participating holders" (p. 24).

The amended Plan (Section 8, p. 95) filed after the bankruptcy proceeding had been instituted, also provides that the Fiscal Agent shall assess charges against "participating bondholders" or "bondholders participating in the Plan". Under neither plan did the City assume any obligation to pay the Refunding Agent; both the original Plan (Section 8, p. 36) and the amended Plan (Section 9, p. 95) say that "such charges being a matter wholly between the Fiscal Agent and the bondholders participating in the Plan".

Before the contract was executed, many creditors had instituted suits against the City for judgments, and had obtained writs of mandamus, some as early as 1936, (pp. 46-48), requiring the levy of taxes to pay their judgments. The City failed or refused to levy the taxes ordered by these writs (p. 179). The Fiscal Agent itself had instituted such a suit, which, it says (p. 175) was first contested, but after the contract was made, was uncontested. On October 8, 1938, the City filed a petition (p. 42) asking the District Court to stay the suits of "litigating creditors", and obtained an order granting the petition (p. 45). But the suit brought by the Fiscal Agent was not included in the injunction. On the contrary, the City levied a tax for the payment of the claim of the Fiscal Agent. The testimony of Mr. Reddick, the City Clerk, (p. 129) is that the levy was made in the Fall of 1937. In 1938, a levy was made "under the Plan" for Refunding Bonds that have never been issued. Such levy could not, under the law of Florida legally be made until after the refunding bonds had been issued or contracted to be issued. *Potter v. Lainhart*, 44 Fla. 647, 33 So. 251, *Osborne v. Stripling*, 81 Fla. 375, 88 So. 265. When the Vice President of the Fiscal Agent was examined as to this, (p. 179) he admitted that he knew no levies had been made for other "litigating creditors", but denied that this was the result of an agreement between the Fiscal Agent and the City. He also admitted that money had been collected by the City from

the levy for the Agent. This money was still held by the City, *but existence of the fund was not disclosed in the Plan of Composition.*

The Court will note that the total of claims Nos 46 and 47, which are covered by judgments, is substantially equal to the total claims of all judgment holders (p. 46-47) who were enjoined, except those of Rittenoure, United Mutual, Sweet and Babson, none of which have accepted the Plan, and the judgment of Security Benefit, which is listed as having consented.

The Fiscal Agent purchased these judgments, though no tax levies had been made for them, and after purchase executed its acceptance of the Plan in their behalf. At the first hearing before the Master, petitioner objected to the proof of claims on these judgments (p. 107-8), but its objections were over-ruled.

These judgments must have been bought after bankruptcy proceedings were instituted, though the record does not disclose when, because the petition to enjoin them was not filed until October 1938 (2 months after the petition was filed). Mr. Jollay acted as attorney for the City in securing this injunction against all suits except that of the Fiscal Agent.

The resolution of the City Council to invoke bankruptcy was passed in May, 1938 (Exhibit C, p. 39). Mr. Lassiter says (p. 195) that this was found necessary "because of the objection of certain litigating creditors to acceptance of the voluntary Plan". Hence, it is reasonable to assume that the Fiscal Agent purchased these claims in order to obtain for the City acceptance of the Plan, and enable the City to show the consent of holders of more than two-thirds of the claims, as required by statute. The judgment creditors, having been unable to compel the City to perform the mandates of the courts requiring the levy of taxes, were probably glad to sell out.

The contract of the Fiscal Agent with the City (p. 36) required it to obtain the consent of the holders of 75% or more to the voluntary Plan within one year. Since only 69% have consented (Master's Report, p. 224), without an amendment of the contract the Fiscal Agent would not have been entitled to assess the consenting bondholders, much less those that did not consent. But a decree of confirmation would be binding upon all creditors. Under these circumstances, we can understand why it was found necessary "to institute bankruptcy proceedings", and also why judgments of "litigating creditors" were purchased.

With no further explanation of this situation, the Court must assume that the claims of judgment creditors were purchased for the purpose of obtaining the consent of the required percentage which would enable the Fiscal Agent and the City to bind all creditors to the Composition, and make them comply with the terms of the same. The amended Plan (pp. 95-99) Section 8, provides for the assessment of "participating bondholders" only. But by the decree confirming the Composition, all creditors are assessed; it enjoins all holders of bonds, judgments, etc, from instituting suits, or from prosecuting them, or taking action to enforce the payment of the same (p. 248), and specifically provides that "upon final decree herein (they) shall be bound thereby in the same manner as all other creditors affected by said Plan of Composition" (p. 249). Paragraph B of the amended Plan (p.95) provides that "evidences *of all interest* accrued to July 1, 1937 shall be deposited in escrow". Paragraph 11 of the decree (p. 250) orders the appointment of an escrow agent, and Paragraph 12 directs the City to take the steps necessary to carry out the Plan. The result of the decree, therefore, is to require *every creditor*, whether a "participating" one or "one who accepted the Plan" or not to deposit their interest claims with the escrow agent and to pay the fee of $40. per bond, or to assign their certificates of deposit in escrow to the Agent, and pay a fee of $20. per bond.

In other words, the purchase of claims by the Fiscal Agent, and its acceptance of the Plan on their behalf, made it possible for the Agent and the City to enforce the terms of the modified Plan by a decree of court, which without purchase they could not have done, and enables the Agent to collect fees from *all bondholders* which was not contemplated by its contract with the City. (Ex. B. p. 36.)

Nowhere in the decree is there anything to indicate that non-consenting bondholders are not bound by the provisions of the modified Plan requiring the deposit or sale of the interest claims. If all interest claims must be deposited, all bondholders must pay the fees to be paid. The decree, therefore, will enable the Agent to collect compensation that its contract with the City did not contemplate or authorize. That plan was "a voluntary adjustment", and even the modified Plan (Section 8) provides that assessments shall be paid only by "participating bondholders".

Summarizing the situation: the contract required the Agent to carry out a voluntary refunding; it was to be compensated by assessing holders who accepted refunding bonds under the terms of the Plan. The modified Plan, (Sec 8, p. 95) by using the same language used in Sec. 8 of the original Plan (p. 24), limited compensation of the Agent in the same way. But through the purchase by the Agent of enough claims, the City obtained acceptance by the required two-thirds, and the decree of confirmation assesses charges against all bondholders, consenting and non-consenting, and compels all bondholders to deposit their interest claims in an escrow which includes the claims purchased by the Fiscal Agent before and after bankruptcy, or else to sell their claims at a discount to the Fiscal Agent. That the profit expected to be earned by the Fiscal Agent through speculation in bonds and coupons is a vital part of the consideration the Agent expects to receive, cannot be denied. Such an implication runs through the entire

testimony of Mr. Lassiter. It appears in the artificial debt structure, in the original Plan to force other holders to sell their coupons at a discount, in the modified Plan that places a higher charge on those who wish to speculate for their own account, as well as in the decree which orders the deposit of *all* evidences of interest with an option of sale to the Agent. Sub-section (b) Section 403, which authorizes allowance of compensation for services rendered, limits it to a "reasonable" one. Since it is impossible to determine what amount will accrue to the Agent from this speculation, and there is not even evidence that this profit would be a reasonable sum, the finding by the court that the compensation provided by the Plan is reasonable, necessarily refers solely to the per bond fees; otherwise it is unsupported by facts.

Under these circumstances, without any statements to the contrary by representatives of the City or the Agent, the Court must conclude that purchase of the claims was for the express purpose of enabling the Agent to assess all bondholders, which it could not do under its contract, and that this was the consideration for their purchase. Equity and the rules applicable to composition and bankruptcy, require that the Court should refuse to confirm a composition procured under such circumstances.

In the case of *In re E. T. Kennedy Co.* 136 F. 451, the court refused to confirm a composition, where it appeared that a committee of creditors had purchased claims for the purpose of buying the property of the bankrupt from the trustee in order to resell the property so purchased for the interest of the creditors who transferred their claims to the committee. The court held that this combination of creditors for the control of judicial proceedings was clearly against public policy.

In *In re Weintrob,* 240 F. 532, the court refused to count a claim which had been purchased to obtain the

necessary 50% where the claim was purchased for the full amount and voted in favor of acceptance of the composition.

In *In re M. & H. Gordon,* 245 F. 905, the court held that no creditor "shall have any advantage, secret or otherwise, over the other" and refused to confirm a composition which involved an agreement on the part of the bankrupt to pay one creditor his expenditures for investigating the financial affairs of the bankrupt, because it would open the door to preferring one creditor above another.

In re Kinnane Co. 221 F. 762, holds that a majority cannot, by accepting a composition, acquire a priority or preference over the dissenting minority.

In *In re Griffith Stillings Press,* 244 F. 315, it was held that the assent of a majority of the creditors was not conclusive on the court if such assent was affected by other considerations.

In *Fairbanks v. Amoskeag Nat. Bank,* 38 F. 630, the court refused to confirm a composition which had been consented to as a result of an agreement by the bankrupt to pay one of his creditors a sum in addition to his pro rata distribution if he would secure the consent of other creditors to the composition. In that case, the creditor bought a number of claims, paying a larger sum than the percentage provided in the composition, and voted them in favor of the composition.

Mr. Lassiter (p. 202-203) said that the price at which the Agent bought these judgments "was in most cases higher than the then current prices for the bonds themselves".

The Municipal Bankruptcy Act requires acceptance by creditors before the petition can be filed. But that does

not change the principle of these decisions; — that the acceptance must be free and uninfluenced, and cannot be obtained by considerations other than the consideration offered to all creditors in the plan of composition. Even though, as the Circuit Court of Appeals held, a plan may provide for the assessment of the expense of the proceeding against creditors, it is none the less inequitable for consent to be obtained through the purchase of non-consenting claims by the Fiscal Agent, which was under a duty "to attempt to complete a refunding of the indebtedness" (p. 163). A consent so obtained is not such a free and uninfluenced act as is required by the terms of the statute.

POINT III.

The decision of the Circuit Court of Appeals of the Fifth Circuit affirming the decree of the District Judge is in conflict with the decision of this Court in the Los Angeles Lumber case, 84 L. ed. 22, because affirmance was predicated solely upon its previous opinion in Vallette v. City of Vero Beach, 104 F. (2d) 59, and its opinion in that case appears to have been influenced by the fact that "the vast majority of the creditors of the City had consented", although the court in its opinion admitted that speculation by the Agent in obligations of its principal (the City) "might lead to discontents or even scandals", a contingency not contemplated or permitted by the Act of Congress authorizing this procedure.

The decision by the Fifth Circuit Court of Appeals rests solely upon the authority of its earlier opinion in *Vallette v. City of Vero Beach,* supra, in which we find the following statement:

> "Grave questions are made touching the compensation of the Fiscal Agent, and its reimbursement for expenses in connection with the plan * * *. As was the Judge (the District Judge) we are troubled by the element of speculation on the Agent's

> part in the old coupons * * * . This may lead to discontents or even scandals, and we do not in principle approve it, but will not over-rule the Judge at this stage of the proceedings and on an imperfect record of what happened before him".

Under these circumstances, it cannot be doubted that in this case also the court was influenced largely, if not controlled, by the fact referred to in the *Vallette* case, that "the vast majority of the creditors had approved the Plan". This approval should not have influenced the decision of the court. Under the opinion of this Court, *Los Angeles Lumber Co.*, supra, the duty imposed upon the District Court is to find that a plan is fair and equitable. In this case, the number consenting, if we exclude the claims owned by the Fiscal Agent and the Brown-Crummer Investment Company, would have been only $415,791. principal and interest out of a total principal and interest claims as of July 1, 1937, amounting to $1,223,757.

The new principal indebtedness of the City will amount to over one and one-quarter million dollars, (less interest paid under the escrow) of which the two Crummer Companies will own over $400,000. The Fiscal Agent would under its contract be vested with "exclusive authority" to act for the City in all matters relating to the refunding for a period of 3 years. Under this clause, control which the Fiscal Agent has exercised over the financial affairs of the City in the past will be extended in time by the large proportion of the debt owned or controlled by it.

Your petitioner not only is fearful, as was the Circuit Court of Appeals, of the effect of speculation by the Agent in the old bonds and coupons purchased by it, but also of the effect of speculation in the new refunding bonds which are to be retired by the City at discounts from their face through the use of the sinking fund under the terms of the Plan.

V.

CONCLUSION

In conclusion, we submit that:—

1. Since the contract is illegal under the laws of the State of Florida, the City has no authority to carry out the terms of the Plan; it is impossible to separate the contract from the Plan, and approval of the Plan necessarily carries approval of the illegal contract.

2. The City has not obtained the free and unbiased acceptance of the Plan by two-thirds of the aggregate outstanding claims, because a large part of the claims that accepted the Plan are owned by the Fiscal Agent of the City, which will receive benefits other than those that accrue to creditors generally. In the absence of testimony to the contrary, this fact is presumed to have influenced its consent.

3. The Plan did not provide that non-participating or non-consenting holders of bonds should be assessed or required to deposit their coupons with the escrow agent. Hence, the decree of the court is broader than the Plan of Composition proposed.

4. The Plan itself is impossible of accomplishment according to its terms, and creditors should not be required to accept obligations that the City admittedly does not intend to perform.

Respectfully submitted,

Giles J. Patterson

Attorney for Petitioner

Sec. 10. The government of the city shall be carried on by the following officers: a Mayor, a City Council consisting of five members, a Superintendent of Public Works, a Chief of Police, a City Clerk and Collector, a City Assessor, a City Auditor and Comptroller, a City Attorney, a Chief of the Fire Department, and such other officers as may be created by ordinances of the city not inconsistent herewith, and they shall perform such duties and receive such compensation as may be prescribed by the ordinances of the city not inconsistent with this charter; Provided, that the Superintendent of Public Works, the Chief of Police, the City Clerk and Collector, the City Assessor, the City Auditor and Comptroller, the City Attorney, and the Chief of the Fire Department, shall be elected by the City Council upon its organization and at its first regular meeting after the general election called and held pursuant to the provisions hereof and the city ordinances, and that all other officers of said city shall be appointed by the Mayor and confirmed by the City Council or elected by the City Council as herein provided; provided further, that the Mayor may in his discretion, in case of emergency to be determined by him, appoint, subject to the confirmation of the Council, a City Auditor and Comptroller who is not a qualified elector of the city. The same person, except the Mayor and members of the City Council, may hold more than one of said offices.

Sec. 17. There shall be elected by the City Council of the City of Avon Park at the first regular meeting in January succeeding the general city election a City Attorney whose term of office shall be for a period of two years; and who shall perform all of the duties imposed upon him by the provisions of this Act, and which are now prescribed or which may hereafter be prescribed by the city ordinances.

Sec. 19. All officers of said city shall before entering upon the discharge of their duties, take and subscribe an oath before some person authorized to administer oaths, that they are entitled to hold the office to which they have been elected or appointed, and shall give bond in such sum as may be required by the City Council, said bond to be

signed by some reputable and duly authorized Security or Guaranty Bonding Company, said bonds to be approved by the City Council, provided, however, the Mayor and members of the City Council shall not be required to give bond.

Sec. 24. That the City Council shall have the power to make, establish and ordain for the Government of said city, and the officers of said city, such ordinances in writing and such by-laws and rules or order not inconsistent with this charter, the Constitution and Laws of the United States and the State of Florida as they may deem necessary; provided, a majority of the City Council shall assent thereto. (Then follows specific enumeration of types of ordinances.)

Sec. 25. The City Council shall have full power to pass such ordinances as it may deem proper for the government of said city, and shall have special power to borrow money by bonding the city for any of the following purposes: first, to improve streets and sidewalks; second, to establish waterworks and fire protection; third, to establish gas or electric light system; fourth, to establish a sewerage system and disposal; fifth, to erect a city market building; sixth, to purchase or erect a school; seventh, to establish a street railway system; eighth, to provide a park or parks and improve the same; ninth, to purchase or erect a city hall or other public building; tenth, to establish and maintain public play grounds and athletic fields; eleventh, for funding and refunding outstanding indebtedness of said city; twelfth, to purchase, establish and maintain tourist camps and buildings, to purchase, construct and maintain any project that the Council may deem of benefit or importance to the citizens of the City of Avon Park.